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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No. 493

LEON R. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LUCILE H. MEYER, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

LEON R. MEYER, TRANSFEREE OF MEYER JEWELRY COMPANY, *Petitioner,*

vs.

THE UNITED STATES OF AMERICA.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

HOMER CUMMINGS,
ALBERT L. REEVES, JR.,
WILLIAM D. DONNELLY,
Counsel for Petitioner,
1625 K Street,
Washington, D. C.

CUMMINGS, STANLEY, TRUITT, CROSS & REEVES,
Of Counsel.

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS.

The plaintiffs in the consolidated cases below pray that a Writ of Certiorari issue to review the judgment therein of the United States Court of Claims.

OPINION BELOW.

The opinion and judgment of the Court of Claims (R. 55-66) are reported at 121 F. Supp. 898, and, together with that court's findings of fact (R. 66) and conclusion of law (R. 82) are printed in the Appendix to this petition.

JURISDICTION.

The judgment of the Court of Claims was entered on June 8, 1954 (R. 55, 66). Plaintiffs' motion for rehearing was timely filed August 30, 1954, (R. 83) pursuant to extension of time duly granted (R. 83), and was denied by order entered October 5, 1954 (R. 83). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1255.

QUESTIONS PRESENTED.

1. Whether Section 112 (b) (3) of the Revenue Act of 1928, providing for tax-free corporate reorganizations, is limited in its application to solvent corporations so that stockholders of an insolvent corporation may never have the benefit thereof, even though creditors voluntarily and intentionally reduce and settle their claims so as to assure the retention by the stockholders of the equity in the reorganized corporation.

2. Whether the right of creditors to exclude stockholders from the reorganization of an insolvent debtor under the *full priority rule,* as announced and explained by the Supreme Court of the United States, must conclusively be deemed to have been exercised as a matter of law, even though it has not been exercised as a matter of fact, but, to the contrary the creditors have voluntarily and intentionally reduced and settled their claims so as to assure the retention of the equity by the stockholders.

STATUTE INVOLVED.

Revenue Act of 1928, c. 852, 45 Stat. 791, 816:

Sec. 112. RECOGNITION OF GAIN OR LOSS

"(a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under Section 111, shall be recognized, except as hereinafter provided in this section.

"(b) Exchanges solely in kind.—

* * * * * * * * * * *

"(3) Stock for Stock on Reorganization.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

STATEMENT.

Meyer Jewelry Company having encountered financial difficulties, a receiver was appointed on March 19, 1931, upon the application of certain of its creditors made at the suggestion of (Tr. 161), and joined in by, the debtor corporation (Fdgs. 12, 13, App'x. 17). While the receivership proceedings were pending, the debtor arranged for a settlement of its liabilities of approximately $88,000 for $22,000, plus administrative and court costs of $6,500 (Fdg. 16), and, pursuant to a written plan of reorganization (Fdg. 17) and with the full knowledge, consent and approval of all of its creditors (Fdg. 15, Tr. 26-29, 44, 45, 49, 50) its assets were acquired by a new corporation with the same name and with the same stockholders—each having a proprietary interest in the new corporation in the same proportion as his interest in the old corporation (Fdg. 18). The stock of the old corporation was turned in and cancelled and the new stock was issued to the same stockholders with no money being paid therefor (Fdg. 18). To repeat, the creditors desired that the stockholders of the old corporation retain the proprietary interest in the new company; the creditors deliberately and intentionally

elected not to eliminate the interests of the stockholders; the stockholders did, in fact, retain an equity having a very substantial actual value. Upon the termination of the receivership proceedings, the equity of the stockholders in the reorganized company was worth in excess of $50,000 (Fdg. 18). The new corporation received and owned the same assets as the old corporation (Fdg. 18).

In July, 1943, the reorganized corporation was liquidated and its assets were distributed to its sole stockholders, Petitioner Leon R. Meyer (plaintiff in case No. 49739) and Petitioner Lucile H. Meyer (plaintiff in case No. 49740) in exchange for their stock (Fdg. 24). In determining the gain to the stockholders on this exchange, the Commissioner of Internal Revenue refused to permit them to carry over as part of the basis of their stock the basis of the stock of the old corporation (Fdg. 28). The Commissioner also determined that the reorganized Meyer Jewelry Company (transferor of plaintiff in case No. 49741) was not entitled to use the capital surplus account of the old corporation in computing equity invested capital of the reorganized company (Fdg. 27). The plaintiffs paid individual income taxes and corporate excess profits taxes in the amounts determined by the Commissioner (Fdgs. 28, 29) and brought suit for refund in the Court of Claims which dismissed their petitions. All three cases turned on the single issue of whether Meyer Jewery Company experienced a tax-free reorganization within the meaning of Section 112 (b) (3) of the Revenue Act of 1928.

The Court of Claims, in denying petitioners' claims, found that in 1931 the Meyer Jewelry Company was insolvent in the bankruptcy sense, and, upon the basis of this finding, concluded as follows:

> (a) notwithstanding the fact that all of the creditors voluntarily and intentionally reduced and settled their claims so as to assure the retention by the stockholders of the equity in the reorganized company, yet

under the *full priority rule* of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482, 33 S. Ct. 554, the interest of the stockholders was nonetheless eliminated as a matter of law;

(b) therefore, the requisite continuity of interest was lacking;

(c) therefore, although all other requirements of a tax-free reorganization had been met, the fact of insolvency, in and of itself, precluded Meyer Jewelry Company from experiencing a tax-free reorganization.

REASONS FOR GRANTING THE WRIT.

1. The decision below erroneously applied the *full priority rule* of this Court in *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482 and *Helvering* v. *Alabama Asphaltic Limestone Co.,* 315 U. S. 179, and, in effect, amended Section 112 (b) (3) of the Revenue Act of 1928 by judicial decree.

The *full priority rule* was announced by this Court in the *Northern Pacific* case, *supra,* as follows, l. c. 482:

> "Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. But, of course, such a transfer by stockholders from themselves cannot defeat the claim of a nonassenting creditor."

and was explained by this Court in the *Alabama Asphaltic Limestone* case, 315 U. S. 179, as follows (p. 183-184):

> "The full priority rule of *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482, applies to proceedings in bankruptcy as well as equity receiverships. *Case* v. *Los Angeles Lumber Products Co.,* 308 U. S. 106. It gives

> creditors, whether secured or unsecured, the right to exclude stockholders entirely from the reorganization plan when the debtor is insolvent."

Summarized, the *full priority rule* of this Court is that creditors of an insolvent corporation are entitled, if they so choose, to eliminate the interest of stockholders. The *full priority rule* is not a conclusive test of a tax-free corporate reorganization; it is a protective rule for the benefit of creditors if they choose to invoke it. But here the creditors, with full knowledge of all of the facts, ably represented by counsel, and acting in their own self-interest, desired that the business be continued under the same management, and, to accomplish such purpose, deliberately and intentionally consented that the stockholders of the old company retain the equity.

In the face of those undisputed facts, the Court of Claims in its opinion held, 121 F. Supp. 898, 904 (R. 63, App'x. pp. 10-11):

> "Therefore, since the old corporation was insolvent in the bankruptcy sense, the creditors, under the full priority rule of *Northern Pacific Ry. Co.* v. *Boyd*, 228 482, could have and *in fact did, as a matter of law,* eliminate the interest of the stockholders in the old corporation." (Emphasis supplied)

Because of the *apparent* similarity between the facts in the Meyer Jewelry Company reorganization and the facts in *Mascot Stove Co.* v. *Commissioner*, 120 F. 2d 153, and in *Templeton's Jewelers, Inc.* v. *United States*, 126 F. 2d 251 (both decided by the Sixth Circuit Court of Appeals with opinion in both cases by Judge Simons), the Court of Claims fell into the error of assuming that the decisions announced in those cases should govern here. However, in neither of those cases did the creditors desire and consent that the stockholders retain the equity in the reorganized company, nor did the stockholders in fact retain the equity in the reorganized company. Therefore, although the *full priority rule* may have been properly applied as the key-

stone of the decision in *Mascot Stove Co.* (on which *Templeton's Jewelers, Inc.*, depends), that rule is not applicable under the factual situation of the Meyer Jewelry Company reorganization. The record is clear that the creditors of Meyer Jewelry Company neither desired nor intended to wipe out the stockholders' equity; on the contrary, they desired and provided for such equity and a continuity of interest. There was, in substance and in reality, a simple settlement of an indebtedness of $88,000 for $22,000.

To say, as did the Court of Claims, that the creditors of Meyer Jewelry Company "could have and in fact did, as a matter of law, eliminate the interest of the stockholders in the old corporation" not only disregards the undisputed facts, but also diverts the *full priority rule* from the role assigned to it by this Court of protecting creditors in the assertion of their rights to the role of protecting them against their wishes and their own judgment of their best interests. As applied by the Court of Claims the *full priority rule* becomes a conclusive presumption of law under which the actual facts and the wishes of the creditors are disregarded. Cases should be decided on actual facts; conclusive legal presumptions to the contrary should only be resorted to in cases involving matters of public policy.

2. The decision of the Court of Claims in the cases below that Meyer Jewelry Company was insolvent in a bankruptcy sense is contrary to its own findings of fact. The Court of Claims actually found: (a) that the merchandise inventory alone as shown on the books of the old corporation had a book value of $107,651.97 (Fdg. 14, App'x 18); (b) that the appraisers appointed in the receivership proceedings valued the assets of the old corporation at $50,211 on the basis of present cash value (not on the basis of a going concern) (Fdg. 14); (c) that the net effect of the settlement of the debts of the old corporation was to increase the book equity of the stockholders by approximately $59,485 (Fdg. 18, App'x 25); (d) that the new corporation received and owned the same assets as the old corporation had held prior to the receivership and that no part

thereof had been liquidated by the receiver (Fdg. 18); (e) that the equity of the stockholders in the new corporation, upon receiving the same from the old corporation, had a book value of $51,161.68, even after the new corporation took a voluntary writedown of $62,751.31 (Fdg. 18, App'x 25).

Obviously, when the liabilities of the old corporation were scaled down to $28,515 with the consent of all of the creditors (Fdg. 16, App'x 10; Tr. 26-29, 44, 45, 49, 50) the old corporation was solvent. To substantiate its conclusion of insolvency in the bankruptcy sense, the Court of Claims necessarily ignored the facts that the settlement with creditors (assented to by them) was made by the old corporation as a part of a plan of reorganization adopted shortly following the filing of the receivership proceedings (Fdg. 17), and that the settlement had been agreed to in the receivership proceedings prior to the acquisition of the assets by the new corporation (Fdg. 16, 17). The Court of Claims in effect has attempted to substantiate its conclusion by stating that since the creditors "could have" they "in fact did, as a matter of law, eliminate the interest of stockholders in the old corporation",—that is to say, that even though the creditors in actuality did settle and reduce the liabilities of the old corporation, still, as a matter of law, they must be presumed not to have done so.

In respect of the essentials of continuity of interest and retention of equity, the Court of Claims also refused to recognize an important distinction between bankruptcy and equity receivership, namely, that in the former title passes by operation of law to the trustee in bankruptcy (*Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734; *Mueller* v. *Nugent*, 184 U. S. 1); while in the latter title remains in the debtor, its property being merely in the custody of the Court (*United States* v. *Weitzel*, 246 U. S. 533; *Quincy, M. & P. R. Co.* v. *Humphreys*, 145 U. S. 82).

3. The limitation judicially appended by the Court of Claims to Section 112 (b) (3) of the Revenue Act of 1928 adversely affects a great number of taxpayers, since the

language of the section has been incorporated substantially without change in all succeeding revenue acts. The *full priority rule* is not limited to tax cases, but is of importance in defining generally the respective rights of creditors and stockholders of insolvent corporations.

CONCLUSION.

For the foregoing reasons, we respectfully submit that the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

HOMER CUMMINGS,
ALBERT L. REEVES, JR.,
WILLIAM D. DONNELLY,
Counsel for Petitioner,

CUMMINGS, STANLEY, TRUITT, CROSS & REEVES,
Of Counsel.

December , 1954.

APPENDIX.

IN THE UNITED STATES COURT OF CLAIMS

(Decided June 8, 1954)

No. 49739

LEON R. MEYER v. THE UNITED STATES

No. 49740

LUCILE H. MEYER v. THE UNITED STATES

No. 49741

LEON R. MEYER, TRANSFEREE OF MEYER JEWELRY COMPANY, v. THE UNITED STATES

Mr. Temple W. Seay for plaintiffs. *Messrs. David L. Sheffrey, Joseph A. Hoskins,* and *Harlow B. King,* were on the briefs.

Mr. J. W. Hussey, with whom was *Mr. Assistant Attorney General H. Brian Holland,* for the defendant. *Messrs. Andrew D. Sharpe* and *Ellis N. Slack,* were on the brief.

OPINION

LITTLETON, *Judge,* delivered the opinion of the court:

Plaintiffs sue for a refund of income and excess profits taxes. In these actions Leon R. Meyer, plaintiff in case No. 49739, claims recovery of individual income taxes paid for the year 1943 in the amount of $14,281.84, plus statutory interest; Lucile H. Meyer, plaintiff in case No. 49740, seeks recovery of individual income taxes paid for the year 1943 in the amount of $7,860.77, plus statutory interest; and

Leon R. Meyer, as transferee of Meyer Jewelry Company, plaintiff in case No. 49741, claims recovery of corporation excess profits taxes exacted from the Meyer Jewelry Company for the fiscal year ending January 31, 1943, and the taxable period beginning February 1, 1943, and ending July 31, 1943, in the respective amounts of $449.34 and $3,395.63, plus statutory interest thereon. These cases were consolidated because all three turn on the single issue of whether the Meyer Jewelry Company underwent a "nontaxable reorganization" within the meaning of those terms in section 112 of the Revenue Act of 1928, 45 Stat. 791, 816-818.

The facts show that in 1931 the assets of the Meyer Jewelry Company (hereinafter referred to as the old corporation) were transferred through a receivership proceeding, wherein the creditors received 25 cents on the dollar, to the new Meyer Jewelry Company (hereinafter referred to as the new corporation) with the stock of the old corporation being cancelled and the stock of the new corporation being issued to the stockholders of the old corporation. The primary issue presented in cases No. 49739, and No. 49740 is whether or not the stockholders of the new corporation were entitled to carry over as a part of the basis of their stock the basis of the stock in the hands of the stockholders of the old corporation for purposes of determining gain or loss on the sale thereof.

The primary issue presented in case No. 49741 is whether or not the new corporation is entitled to use the book value of the "capital surplus" account of the old corporation in computing the equity invested capital of the new corporation. The salient facts with reference to this follow.

The Meyer Jewelry Company (old corporation) was incorporated in 1890 under the laws of the State of Missouri with authorized capital stock of $2,000, all of which was benficially owned by Lewis Meyer, father of Leon R. Meyer. The old corporation encountered financial difficulties on several occasions and in 1921 a composition settlement was made with its creditors for 40 cents on a dollar. Mrs. Rika R. Meyer, mother of Leon R. Meyer, frequently loaned

money to the old corporation. On March 4, 1925, Lewis Meyer sold and transferred all of the stock of the old corporation to Mrs. Rika R. Meyer for a consideration of $30,570.15. The capital stock of the old corporation was subsequently increased several times and on March 1, 1928, Mrs. Rika Meyer beneficially owned all the outstanding stock, which was 500 shares of common and 450 shares of preferred, for which she had paid $45,000 additional consideration. Sometime prior to 1931 she gave 50 shares of this stock to Leon Meyer.

Again, at the beginning of 1931, the old corporation was in financial difficulty and unable to pay its debts, and once more it undertook to make a composition settlement with its creditors, but, on March 19, 1931, while negotiations were being carried on, certain creditors with note claims in excess of $3,100 filed receivership proceedings against the corporation in the United States District Court for the Western District of Missouri. On the same day the old corporation joined in the request for the appointment of a receiver and Leo H. Ludwig was appointed receiver on that day. The assets of the old corporation were accordingly turned over to the receiver and he operated the business until it was subsequently sold. Although the merchandise inventory alone had a book value of $107,651.97, three independent appraisers appointed by the court, in their report submitted on July 3, 1931, appraised all of the assets of the old corporation at $50,211. This was a fair appraisal. This appraisal of $50,211, when compared with the existing liabilities of the old corporation of approximately $88,000, showed that the old corporation was insolvent in the bankruptcy sense.

Shortly after the receiver was appointed the stockholders of the old corporation, Mrs. Rika Meyer, who owned 900 shares, and Leon Meyer, who owned 50 shares, adopted a "plan of reorganization" which is set forth in finding 17. Pursuant to the stockholders' desire, Louis Oppenstein, acting as their agent, undertook negotiations with the receiver to *purchase* the assets of the old corporation. The

creditors were aware of the fact that the stockholders wanted to purchase the assets of the old corporation through Mr. Oppenstein. On July 6, 1931, the receiver submitted his report to the court showing Oppenstein's offer to purchase free and clear of all liens, claims or incumbrances of any kind, all the assets of the old corporation for an amount sufficient to pay 25 percent of all lawful claims of the old corporation's creditors; plus all taxes required to be paid by the receiver; plus all preferred claims, plus the court costs of the receivership; plus the receiver's fees, and plus all costs and legal expenses incurred by the Manufacturing Jewelers Board of Trade which had been acting as representative of various creditors of the old corporation. On July 9, 1931, the court authorized and directed the receiver to sell, at a private sale, the assets of the old corporation to Oppenstein pursuant to his offer, and on July 17, 1931, the receiver submitted his report showing the sale to Oppenstein of all the assets of the old corporation. The total cost of the assets of the old corporation to Oppenstein was $28,515. Mrs. Rika Meyer furnished the money for this transaction. The stockholders organized the new corporation under the laws of the State of Missouri on July 17, 1931, with the authorized capital stock of 300 shares of $100 par value common stock going to them in about the same ratio that they held in the old corporation, 285 to Rika and 15 to Leon. The stock of the old corporation was turned in and cancelled with no money being paid for the new stock. On July 20, 1931, at a combined meeting of the stockholders and directors, the same plan of reorganization, which is set forth in finding 17, was adopted by the new corporation. This plan is not contained in, or referred to by, the record of the District Court of the insolvency receivership proceedings. The new corporation took over the business and operated it continuously until July 31, 1943. The net result of the receivership proceedings was the elimination of an $88,000 liability for $22,000 plus incidental expenses. The new corporation assumed a note for $25,000, which rep-

resented the money furnished by Mrs. Rika Meyer for Oppenstein to purchase the assets of the old corporation. This note was subsequently paid. On July 20, 1931, the new corporation wrote down the assets to a fairer value for a going concern. As indicated in the balance sheet, which is set forth in finding 18, the going concern value of the assets purchased from the old corporation was $87,616.01, still less than the liabilities of the old corporation.

Leon Meyer made cash contributions to surplus in the amount of $11,500, $1,500 on March 31, 1937, and $10,000 on January 30, 1940. On December 29, 1941, Mrs. Rika Meyer made a gift to Leon Meyer of all of her shares, 284 120/945ths, and reported the same for federal gift tax purposes, thus making Leon Meyer the beneficial owner of all of the outstanding stock of the new corporation. On July 27, 1943, Leon Meyer made a gift of half of the shares (150) to his wife, Lucile Meyer, and reported the same for federal gift tax purposes. On the same day a plan of liquidation of the new corporation was adopted and the assets were transferred to Leon and Lucile Meyer equally on July 31, 1943, in exchange for their stock. The value of the assets thus distributed is stipulated to have been $94,887.61 and this is the sum to be used in ascertaining the profit derived from the liquidation. Leon Meyer was appointed as Liquidating Agent.

The Commissioner of Internal Revenue treated the transfer of the old corporation's assets to the new corporation, with the cancellation of the old stock and issuance of the new stock, as a taxable exchange and determined the basis of the stock held by Leon and Lucile Meyer to be $11,500, which represented the cash contributions made by Leon Meyer subsequent to the 1931 transfer.

The $11,500 basis was allocated by the Commissioner of Internal Revenue 13/15ths, or $9,966.67 to Lucile, and 2/15ths, or $1,533.33 to Leon Meyer. This allocation was made upon the grounds first, that the $11,500 became the cost of the 15 shares Leon then held, secondly, that the oldest 15 shares outstanding at the time of liquidation car-

ried the basis of $11,500 and, thirdly, that the oldest shares outstanding were two qualifying shares owned beneficially by Leon and 150 shares owned by Lucile Meyer. If the basis used by the Commissioner of Internal Revenue and the allocation thereof are correct, the capital gain to Lucile Meyer was $37,477.13 and to Leon Meyer was $45,910.48. The Commissioner determined and collected the taxes computed on these bases. If the Meyer Jewelry Company experienced a "non-taxable reorganization" in 1931 within the meaning of those terms as used and intended in sections 112 and 113 of the Revenue Act of 1928, the aggregate gain to plaintiffs Leon and Lucile Meyer, upon the liquidation of the new corporation in 1943, would be $7,817.46. This would be the aggregate gain because Leon and Lucile Meyer would be entitled not only to their cost basis, but also to the cost basis of the stock in the hands of the stockholders of the old corporation. Thus computed, the basis of their stock would be $87,070.15, which is the aggregate of the $30,570.15 paid by Mrs. Rika Meyer for the original stock of the new corporation, the $45,000 paid by Mrs. Rika Meyer when the capital stock was increased, and the $11,500 cash contributions made by Leon Meyer.

The Commissioner of Internal Revenue determined and collected excess profits taxes for the fiscal year ending January 31, 1943, and the taxable period beginning February 1, 1943, and ending July 31, 1943, in the respective amounts of $449.34 and $3,395.63, using an equity invested capital of $77,232.83 and $86,867.31 respectively.

Plaintiff in case No. 49741, contends that the equity invested capital for the fiscal year ended January 31, 1943, and the taxable period beginning February 1, 1943, and ending July 31, 1943, should have been $130,100.55 and $136,812.05, respectively. The principal part of this differential is attributable to the desire of plaintiff to include the book value of the "capital surplus" account of the $62,810.31 of the old corporation in the computation of the equity invested capital of the new corporation. Plaintiffs' claims for refunds were rejected on the ground that the

Meyer Jewelry Company did not undergo a "nontaxable reorganization in 1931."

The plaintiffs contend that the Meyer Jewelry Company experienced a reorganization in 1931; that this reorganization was a "nontaxable reorganization" because it meets the requirements of section 112 (b) (3) and (i) of the Revenue Act of 1928;[1] that they also meet the requirements of

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[1] Revenue Act of 1928, 45 Stat. 791, 816-820.

SEC. 112. RECOGNITION OF GAIN OR LOSS. (a) General rule.—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) Exchanges solely in kind—

* * * * * * * * * *

(3) STOCK FOR STOCK ON REORGANIZATION.—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

* * * * * * * * * *

(5) TRANSFER TO CORPORATION CONTROLLED BY TRANSFEROR.—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * * * * * * *

(i) Definition of reorganization.—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred. * * *.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations

section 112 (b) (5) of that Act; that having satisfied the requirements of section 112 they are entitled, under section 113 (a) (6) or (7) of that Act, to the carryover bases of the stockholders of the old corporation in determining the gain on the sale of their stock and to have the book value of the "capital surplus" account of the old corporation included in the computation of equity invested capital. The pertinent portion of these sections is set forth in footnote 1.

The defendant contends that the 1931 transfer of the assets and stock of the old corporation to the new corporation was a taxable exchange and therefore the Commissioner of Internal Revenue's determinations are correct.

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in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation. (j) Definition of control.—As used in this section the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

SEC. 113. BASIS FOR DETERMINING GAIN OR LOSS. (a) Property acquired after February 28, 1913.—The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; except that—

* * * * * * * * * *

(6) TAX-FREE EXCHANGES GENERALLY.—If the property was acquired upon an exchange described in section 112 (b) to (e), inclusive, the basis shall be the same as in the case of the property exchanged, decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized upon such exchange under the law applicable to the year in which the exchange was made. * * * This paragraph shall not apply to property acquired by a corporation by the issuance of its stock or securities as the consideration in whole or in part for the transfer of the property to it;

(7) TRANSFERS TO CORPORATION WHERE CONTROL OF PROPERTY REMAINS IN SAME PERSONS.—If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same per-

The plaintiffs first claim that they fall within the literal language of section 112 (b) (3) and (i) (1) (A) and (B). The plaintiffs further claim that the transfer in 1931 was for a business purpose and was brought about by a business exigency and therefore this principle, established in *Gregory* v. *Helvering*, 293 U. S. 465, is satisfied. The plaintiffs also claim that there was a carefully defined written "plan of reorganization"; a retention of the firm name; the transfer of all the assets of the old corporation by a private sale to the new corporation; the issuance of all the stock of the new corporation to the stockholders of the old corporation in the same ratio as their stockholdings were in the old corporation; and the operation of the business without interruption with the same assets and family stockholders until 1943. With these points we agree and we also agree that a transfer of the assets to a new corporation through an agent does not prevent the application of this section if the transfer is a part of an integrated plan. *Helvering* v. *Alabama Asphaltic Limestone Co.*, 315 U. S. 179, 184.

It is now settled that literal compliance with the language of this section is not always determinative of nonrecogni-

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sons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer;

(8) SAME—CORPORATION CONTROLLED BY TRANSFEROR.—If the property was acquired after December 31, 1920, by a corporation by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made; * * *

tion of gain or loss on the exchange. *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 287 U. S. 462, and numerous cases following that decision.

The 1931 transfer on the surface, seems to have met all the requirements for a "nontaxable reorganization" under section 112 of the 1928 Revenue Act, except for one, the renowned and crucial "continuity of proprietary interest" requirement. This requirement, introduced in *Cortland Specialty Co.* v. *Commissioner,* 60 F. 2d 937, (2nd Cir.) and given prominence in *Pinellas Ice & Cold Storage Co.* v. *Commissioner, supra; Helvering* v. *Minnesota Tea Co.,* 296 U. S. 378; *LeTulle* v. *Scofield,* 308 U. S. 415; *Helvering* v. *Alabama Asphaltic Limestone Co., supra;* and *Detroit Michigan Stove Company* v. *United States,* — C. Cls. — Docket No. 48600 (today decided), is dispositive of this case. We believe that it is within the purview and spirit of this requirement that there be a real proprietary interest in the old corporation to continue in the new corporation. Here lies plaintiffs' insuperable barrier because the old corporation was insolvent, in the bankruptcy sense, in that the aggregate fair valuation of its assets was less than its liabilities.

Planitiffs contend that the old corporation was not insolvent in the bankruptcy sense, but this position is clearly not supported by the evidence. On the contrary, the three independent appraisers, who were appointed by the court, found the assets to have a value of only $50,211, when the liabilities were $88,000. The creditors, who were desirous of obtaining all they could on the sale of these assets, were compelled to accept $22,000 in settlement of their claims. It is true that these figures probably did not represent the going concern value. Cf. *New Jersey Mortgage and Title Co.* v. *Commissioner,* 3 T. C. 1277, 1289. The value placed on these assets by the new corporation, which was closer to the going concern value, was still less than the liabilities of the old corporation. Under the facts of this case we are of the opinion that even the going concern value of the old corporation was not as much as $88,000. Therefore, since

the old corporation was insolvent in the bankruptcy sense, the creditors, under the full priority rule of *Northern Pacific Ry Co.* v. *Boyd,* 228 U. S. 482, could have and in fact did, as a matter of law, eliminate the interest of the stockholders in the old corporation. The insolvency of the old corporation in the bankruptcy sense, gave the creditors an effective command in fact and in law over the assets of that corporation. *Helvering* v. *Alabama Asphaltic Limestone Co., supra.* The creditors exercised this command through the receivership proceedings by compelling the liquidation of the old corporation and the sale of its assets for the highest obtainable price under the circumstances. The economic and equity interest, as such, of the stockholders of the old corporation was thus eliminated and the stock if that corporation was absolutely worthless at the time of the alleged reorganization.

Section 112 (b) (3) provides:

> No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, *exchanged* solely for stock or securities in such corporation or in another corporation a party to the reorganization. [Emphasis supplied.]

It is our opinion that the term "exchange" in this context, connotes the transfer of stock in consideration of stock, and not a transfer of valuable stock for absolutely worthless stock, as was the case here. The stockholders of the old corporation had no equity interest to continue or to carry over to the new corporation in "exchange" for the stock of that corporation. The ownership of the stock of the new corporation was not dependent upon or by virtue of the ownership of the stock of the old corporation, but rather by virtue of the purchase of the assets at the receivership sale. The assets were purchased at a bargain, but the difference between the purchase price and the value of the assets was not attributable to ownership of stock in the old corporation nor did it represent an equity in the old corpo-

ration. The stockholders of the old corporation stood in the same position as any purchaser at the sale of the assets insofar as having any legal or equitable interest in the assets of the old corporation.

The nonrecognition provisions were enacted into the revenue laws to prevent the taxation of transfers that in the business sense did not really involve a gain or loss, but only a reshuffling of the same interest. In the cases before us there was a clearly defined business and economic loss, the stock of the old corporation was absolutely worthless and we see no reason why the loss should not have been recognized.

The court in *Mascot Stove Co.* v. *Commissioner,* 120 F. 2d 153, *cert. denied* 315 U. S. 802; and *Templeton's Jewelers, Inc.* v. *United States,* 126 F. 2d 251, reached the same result under similar circumstances for substantially the same reasons. The plaintiffs contend, however, that these cases are distinguishable because in those cases there was a clear break in title to the assets between the old corporation and the new corporation. However, assuming, there was no break in the legal title in the instant cases, we do not believe that that factor is of any legal significance because it is undisputed that the entire business was continued by the same owners. It is also true that it was the lack of this continuation of the business by the same owners that gave birth to the "continuity of proprietary interest" rule. However, as we have stated earlier, we are of the opinion that it is inherent in this rule of continuity of interest that there be an equity interest to continue. We therefore hold that the Meyer Jewelry Company did not experience a "nontaxable reorganization" in 1931.

The plaintiffs also take the position that the transfer of the properties of the old corporation to the new corporation qualifies for non-recognition of gain or loss under section 112 (b) (5) of the Revenue Act of 1928. This section provides:

> No gain or loss shall be recognized if property is transferred to a corporation by one or more persons

> solely in *exchange* for stock or securities in such corporation, * * * [Emphasis supplied.]

In order for plaintiffs to come within this section they must show that their stock was the "property" that was transferred to the new corporation in "exchange" for the stock of that corporation. We do not believe that the 1931 transfer involved an "exchange" within the purview of this section. The term "exchange" in this context, clearly connotes the transfer of something of value for the stock, one being given in consideration of the other. Here, the stock of the old corporation was absolutely worthless at the time of the sale of the assets and at the time of the transfer of the stock and therefore could not be "exchanged" for the stock of the new corporation within the meaning of the statute.

Although not presented by counsel, there is some question as to whether this transaction would have been taxable under section 112 (a) because section 112 (b) (5) may, but not necessarily, only cover the exchange itself and not the antecedent steps in connection with a plan of reorganization. Cf. *Helvering* v. *Central Investors, Inc.*, 316 U. S. 527, 534. However, in view of our holding we need not express an opinion on this question at this time.

We therefore conclude that plaintiffs have failed to show that the 1931 transfer involved an exchange within the meaning of section 112 (b) (3) or (5) and accordingly, the defendant's determinations are correct and the petitions are dismissed.

It is so ordered.

MADDEN, *Judge;* WHITAKER, *Judge;* and JONES, *Chief Judge,* concur.

Judge LARAMORE took no part in the consideration or decision of these cases.

FINDING OF FACT

The court, having considered the evidence, the report of Commissioner William E. Day, and the briefs and argument of counsel, makes findings of fact as follows:

1. Plaintiffs Leon R. Meyer and Lucile H. Meyer are husband and wife residing in Kansas City, Missouri.

2. The original Meyer Jewelry Company was incorporated under the laws of the State of Missouri in 1890 by Lewis Meyer, father of plaintiff Leon R. Meyer, with authorized capital stock of $2,000 divided into 40 shares of common of a par value of $50 each. The entire stock was beneficially owned by Lewis Meyer. Hereinafter, for convenience, the Meyer Jewelry Company incorporated in 1890 will be referred to as the "old" corporation and the Meyer Jewelry Company incorporated in 1931 will be referred to as the "new" corporation. Temporary changes of name to Midwest Jewelry Company in 1931 and 1943 served only to preserve the right to use the name Meyer Jewelry Company by successor businesses.

3. Meyer Jewelry Company (new) was incorporated under the laws of the State of Missouri on July 20, 1931. It was dissolved on July 31, 1943, and its assets were distributed to its stockholders Leon R. and Lucile H. Meyer. It was succeeded by a copartnership composed of Leon and Lucile H. Meyer using the same business name. The copartnership was succeeded after two years (about 1945) by another Meyer Jewelry Company, incorporated in Missouri, with the same stockholders.

4. The old company was originally a jewelry repair shop. It added a wholesale department dealing in watch materials shortly after 1900, and prior to 1922 tools and small jewelry items were added to its line of merchandise. Sometime after 1923, when Leon R. Meyer, Lewis Meyer's son, joined the business, its wholesale business was further expanded to include small appliances, luggage and cameras.

5. The old company repeatedly experienced financial difficulties. Mrs. Rika M. Meyer, Lewis Meyer's wife, from time to time furnished funds with which company obligations were met. Such funds were credited to her upon the books of account of the old corporation, in some instances in her open account, and in others notes were issued as security for the obligation, in which events the credit was made to her notes payable account in such books.

Just prior to May 1921, the old company encountered a general business depression with a consequent break in the diamond and jewelry market. Its merchandise being of a luxury nature, the business of the corporation was very sensitive to market conditions. In May 1921, the old company made a composition settlement with its creditors for 40 cents on the dollar. In that settlement Mrs. Rika R. Meyer, along with other creditors of the corporation, accepted 40 percent of her open account credit on the books of the corporation. Her credit at the time was $8,187.97, and 40 percent of that amount, or $3,275.19, remained as a credit on the books of the old corporation due her after the composition settlement. The difference, therefore, between such two figures, $4,912.78, was the amount surrendered by Mrs. Rika R. Meyer in such composition settlement.

6. At January 31, 1925, Mrs. Rika R. Meyer's combined note and open account showed credit balances due her from the company of $38,381.75. On that same day the books showed that Lewis Meyer was indebted to the company in the sum of $30,570.15.

On March 4, 1925, Lewis Meyer borrowed from a friend $30,570.15, and on the same date paid that amount to the company in satisfaction of his debt to it. On the same day the corporation paid the same amount to Mrs. Rika R. Meyer by check, debiting her note account in such amount, and she in turn by check on the same day paid the amount borrowed by Lewis Meyer from his friend. The net result of these transactions on March 4, 1925, was that Lewis Meyer paid $30,570.15 of his indebtedness to the company,

Mrs. Rika R. Meyer was paid $30,570.15 of the amounts owed to her by the company, and Lewis Meyer then was personally indebted to Mrs. Rika R. Meyer in the sum of $30,570.15.

7. At about March 4, 1925, Lewis Meyer transferred and assigned all of the stock in the old company (40 shares at $50 per share) of a par value of $2,000 to Mrs. Rika R. Meyer in consideration of the payment of the indebtedness of $30,570.15 referred to in the preceding finding, and for other monies previously received, the amount of which is not determinable.

8. On April 27, 1925, the authorized capital stock of the old corporation was increased from $2,000 to $60,000, divided into 500 shares of common stock and 100 shares of preferred stock, all of a par value of $100 per share. On April 30, 1925, a common stock dividend was authorized and issued in the amount of $48,000. This amount was charged to the old company's surplus account on April 30, 1925, and represents 480 shares of new common stock issued to Mrs. Rika R. Meyer. The 40 shares of old common stock of $50 par value was exchanged for 20 shares of the new common stock, whereby the entire 500 shares of new common stock were issued to Mrs. Rika R. Meyer.

On the same day, the 100 shares of preferred stock were issued to Mrs. Rika R. Meyer whereby the old company cancelled its indebtedness to her by a charge of $10,000 to her open account on its books April 30, 1925.

9. Lewis Meyer died on September 11, 1927, leaving no estate to be probated. He had, however, insurance policies on his life payable to Mrs. Rika R. Meyer in a net amount of $70,000.

On October 5, 1927, the stockholders of the old company voted to increase the preferred stock from 100 shares to 600 shares of the par value of $100. On the same day Mrs. Rike R. Meyer turned over $35,000 in cash to her son, Leon R. Meyer, for use of the old corporation, in payment for

350 shares of the new preferred stock of the corporation, when issued.

10. On March 1, 1928, the authorized capitalization of the old company was further increased in accordance with the action by the stockholders described in the preceding finding from $60,000 to $110,000, divided into 500 shares of common and 600 shares of six percent preferred stock, both of a par value of $100 per share. Of the additionally authoried 500 shares, 350 shares were issued to Mrs. Rika R. Meyer. By this time she had 500 shares of common and 450 shares of the preferred stock.

11. Sometime prior to 1931, Mrs. Rika M. Meyer gave 50 shares of stock to her son, Leon R. Meyer. This left her holding 900 shares of the total shares then outstanding.

12. Again, at the beginning of 1931, the old company was in such financial difficulty that it was faced with bankruptcy. It once more undertook to make a composition settlement with creditors, but while negotiations were continuing, certain creditors with note claims in excess of $3,100 filed receivership proceedings against the corporation in the United States District Court for the Western District of Missouri. The action was styled, "Jacob Davis, David Davis, Albert Davis, Maurice Davis, Bennett Davis and Annie Davis, a co-partnership doing business as 'Barnett Davis,' Plaintiffs, versus Meyer Jewelry Company, a corporation, Defendant, Equity No. 1589."

13. The receivership proceedings were instituted on March 19, 1931, and on the same day, upon the joint requests of plaintiffs and defendant therein, the court entered its order appointing one Leo H. Ludwig as receiver. The court's order turned over to the receiver all "of the properties of the defendant, real, personal and mixed, and of whatsoever kind and description, including all lands, real estate, buildings, premises and appurtenances owned, controlled, leased or operated by defendant, and all mate-

rials, supplies, merchandise, books of account, records and other books, papers and accounts, cash on hand, in bank or on deposit, things in action, credits, stocks, bonds, securities, leases, contracts, muniments of title, bills and accounts receivable and the assets and property of all and every kind or character and description whatsoever of said defendant wheresoever situated." The order of the District Court appointing the receiver for the old corporation authorized and directed the receiver to preserve, manage and operate the business of the old corporation, to compromise and settle out of any funds coming into his hands as receiver all claims and demands against the defendant corporation, and by order dated June 24, 1931, authorized the receiver to sell all assets of the old corporation at public or private sale, subject to the orders and approval of the court.

14. The receiver took over all assets of the old corporation and, among his other activities, operated the jewelry business for a period of approximately four months. Whereas the merchandise inventory alone, as carried on the books of the old corporation at the time, showed a book value of $107,651.97, independent appraisers appointed by the court submitted their report on July 3, 1931, showing the value of all items included in the receiver's inventory as follows:

Articles	
Tools and materials	$10,000.00
Stones and emblems	2,000.00
Machinery	1,000.00
Diamonds	8,511.00
Metals	3,500.00
Mountings	3,000.00
Book accounts and notes	14,000.00
Cash	8,200.00
Total	$50,211.00

The foregoing represents the only appraisal of the old corporation's assets made under authority of the court and the receiver. The appraisers stated in their report

"that said appraisement has been based upon the present cash market value of the goods and materials, and that the Accounts Receivable are appraised at the amount of probable recovery based upon the experience of the appraisers."

A comparison of the aforegoing appraisal of $50,211 with the liabilities of approximately $88,000, indicates that the old corporation was insolvent in the bankruptcy sense.

15. During the pendency of the receivership, Leon Meyer contacted his friend, Louis Oppenstein, and caused him to undertake to negotiate a purchase of the assets of the old corporation from the receiver on terms which would be satisfactory to the receiver and the court. Louis Oppenstein thereafter acted as an agent for the sole stockholders of the old corporation, Leon Meyer and his mother, Mrs. Rika R. Meyer, in all matters relating to the Meyer Jewelry Company. The creditors were aware of this agency relationship.

16. On July 6, 1931, the receiver of the old corporation submitted his report to the court showing that an offer had been received from one Louis Oppenstein of Kansas City, Missouri, to purchase free and clear of all liens, claims or encumbrances of any kind all the property and assets of every kind and character of the old corporation for an amount sufficient to pay 25 percent of all lawful claims of the old corporation's creditors, plus all taxes required to be paid by the receiver, plus all preferred claims, plus the court costs of the receivership, plus the receiver's fees, plus all costs and legal expenses incurred by the Manufacturing Jewelers Board of Trade acting as representative of various creditors of the old corporation. On July 9, 1931, the court authorized and directed the receiver to complete the sale of all assets of the old company, including any trade names and good will, to said Louis Oppenstein upon the terms set forth in the offer. The court also noted that the property of the old corporation had been appraised by disinterested appraisers whose report to the court showed a total valuation of the old corporation's assets as

$50,211 but which sum the receiver reported he had been unable to realize on the assets. On July 17, 1931, the receiver submitted his report to the court showing the sale to Louis Oppenstein of all assets of every character belonging to the old corporation under the terms of the original offer. The report acknowledged receipt from Louis Oppenstein of $22,000, which was sufficient to satisfy the terms of the offer with respect to settling with creditors. The total cost to Louis Oppenstein for all assets of the old corporation, including the charges of receivership and the court costs, aggregated $28,515. The receiver's accounts were approved, and the receiver was discharged on August 28, 1931.

17. After it became evident that Louis Oppenstein's negotiations with the receiver for the purchase of the assets of the old corporation would be successful, Leon R. Meyer and his mother, Mrs. Rika R. Meyer, on July 17, 1931, caused a new corporation to be organized under the name of Meyer Jewelry Company. The authorized capital stock of the new corporation was 300 shares of $100 par common stock. The certificate of incorporation was issued by the Secretary of State of Missouri on July 20, 1931. On that same day a combined meeting of the stockholders and directors of the new corporation was held. The meeting was notified of the receipt of the certificate of incorporation, and by-laws were adopted.

The following resolution was adopted at such meeting:

> WHEREAS, a corporation known and designated as Meyer Jewelry Company was incorporated under the Laws of the State of Missouri on January 27, 1890, and,
>
> WHEREAS, subsequent thereto (and pursuant to the plan of reorganization hereinafter mentioned), the corporation name thereof was, in the manner provided by Law, changed to Midwest Jewelry Company, which company at the time of such change was in financial difficulty, and,
>
> WHEREAS, as the result of such difficulties a reorganization plan was evolved under which the assets of said

company were to be taken over by this corporation then in contemplation of organization, under and pursuant to, and in accordance with the provisions of the said plan of reorganization, and,

WHEREAS, under said plan of reorganization it is contemplated that the stockholders of the corporation evolving from said reorganization shall be identically the same as to actual ownership of stock as were those in the said Midwest Jewelry Company, and,

WHEREAS, the stockholders in the Midwest Jewelry Company are as follows:

Mrs. Rika R. Meyer	894 shares [2]
Leon R. Meyer	50 shares
H. P. Pierce (held nominally by the said Pierce but belonging to Rika R. Meyer)	1 share

and the actual owners of the corporate stock of this corporation at the time of incorporation were and are as follows:

Mrs. Rika R. Meyer	284 shares
Leon R. Meyer	15 shares
Fred J. Wolfson (held nominally by the said Fred J. Wolfson but by him held in trust 120/945 for Rika Meyer and 825/945 for Leon Meyer), and	1 share

WHEREAS, this corporation was formed for the purpose of effectuating and carrying out said plan of corporate reorganization and to relieve the said Midwest Jewelry Company (formerly Meyer Jewelry Company as aforesaid) from its said financial difficulties under a settlement with its creditors, all as contemplated in said corporation reorganization plan.

NOW, THEREFORE, BE IT RESOLVED that this corporation hereby ratifies, confirms, approves and adopts said reorganization plan, and agrees to be bound thereby to the extent therein provided, and

BE IT FURTHER RESOLVED that pursuant to said plan this corporation shall and hereby does receive, accept

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[2] The plan states that Mrs. Rika Meyer is the owner of 895 shares, whereas she actually owned 900 shares. This difference is attributable to an oversight of the draftsman of the plan. The five shares were qualifying shares held by a Mr. Fricke and were beneficially owned by Mrs. Rika Meyer.

and take over all of the corporate assets of the said Midwest Jewelry Company, as the same are shown and described on its books and records, and at the values shown upon its books and records as of the date hereof.

BE IT FURTHER RESOLVED, that the nominal incorporators of this company, viz:

Louis Oppenstein,
Leon R. Meyer, and
Fred J. Wolfson,

cause the shares of stock nominally by them described (but in reality in trust for and as the agents of the actual stockholders of this corporation, to-wit: Mrs. Rika R. Meyer and Leon Meyer) to be transferred unto the actual and beneficial stockholders of this corporation viz: Mrs. Rika R. Meyer and Leon Meyer, or their nominees, so that the records of this corporation will show the actual ownership of said stock to be as follows:

a. Mrs. Rika R. Meyer ..... $284^{120}/_{945}$ shares
b. Leon R. Meyer ..... $15^{825}/_{945}$ shares

and

BE IT FURTHER RESOLVED, that pursuant to said plan of reorganization this corporation receive and accept of and from the said stockholders of the Midwest Jewelry Company, all of the outstanding capital stock thereof represented by the following holdings:

Name of owner	*No. of shares*
Mrs. Rika R. Meyer	894
Mrs. Rika R. Meyer (standing in the name of H. R. Pierce and by him endorsed in blank and held and owned by Mrs. Rika R. Meyer)	1
Leon R. Meyer	50

but that the said stock, being represented by new assets (since this corporation has received, accepted and taken over as a part of the reorganization plan, all of the assets of the said Midwest Jewelry Company) be not treated, listed or shown as an asset of this corporation, or as of any value.

BE IT FURTHER RESOLVED that the business heretofore operated by the said Midwest Jewelry Company, and

taken over under said reorganization plan by this corporation, be continued as a going concern under the present name of this corporation viz: Meyer Jewelry Company, and that its continuance be uninterrupted in accordance with said plan of reorganization.

BE IT FURTHER RESOLVED that from and out of the assets received and taken over from the said Midwest Jewelry Company, and the additional assets contributed to this corporation by its stockholders, or obtained by this corporation as a loan, that the debts and liabilities of the said Midwest Jewelry Company be, in accordance with said plan of reorganization and to the extent therein provided, satisfied and liquidated.

BE IT FURTHER RESOLVED, that in accordance with the said plan of reorganization, this corporation shall, and it hereby does, bind itself to acquire the assets of the said Midwest Jewelry Company, for a sum equal to the administrative expenses of receivership proceedings heretofore instituted and pending against the said Midwest Jewelry Company (formerly Meyer Jewelry Company) plus preferred charges, plus a sum sufficient to pay the creditors of the said Midwest Jewelry Company twenty-five (25¢) cents on the dollar, and that upon the acquisition of said assets by this corporation that this company proceed to settle the claims of said creditors on said basis and to discharge and liquidate the said administrative expense and preferred charges in the manner provided in said plan.

BE IT FURTHER RESOLVED, that the Executive Officers of this corporation be and they hereby are authorized, directed and empowered to borrow such sums of money as may be further required or necessary, and permit this company to effectuate said plan and carry on its current business, and that said additional sums may be acquired by this company from its stockholders, directors, or otherwise, and that in such case and for such sums so acquired this Company may issue its obligations either in direct form or as an account payable upon its books, and to that end the Executive Officers of this corporation are further empowered and authorized to execute as accommodation endorsers corporate notes of this company for and in respect to any such sums so advanced under or for this company by any of its officers, directors, stockholders or others.

BE IT FURTHER RESOLVED that the officers and directors of this corporation be and they hereby are authorized, empowered and directed to use such sums or sums out of the capital or assets of this corporation as may be necessary to assume and discharge the said administrative expenses of said equity proceeding, plus all preferred charges, plus a sum sufficient to pay said creditors as aforesaid.

BE IT FURTHER RESOLVED that the signatures to the Minutes shall evidence an agreement of reorganization as herein set forth, the parties signing the Minutes being all of the real parties in interest except those acting in a representative capacity as herein recited.

The "Plan of Reorganization" referred to in the foregoing minutes had previously been adopted by the stockholders of the old corporation (being the same individuals as the stockholders of the new corporation) shortly after the filing of the receivership proceedings. This plan is not contained in, or referred to by, the record of the District Court of the receivership proceedings.

18. At the time of the receivership proceedings, the old Meyer Jewelry Company had outstanding at least 945 shares (see footnote in finding 17) of capital stock held by the following:

Mrs. Rika R. Meyer	895 shares	94.71%
Leon R. Meyer	50 shares	5.29%

The new Meyer Jewelry Company issued 300 shares of stock which were beneficially owned by the following:

Mrs. Rika R. Meyer	$284^{120}/_{945}$ shares	94.71%
Leon R. Meyer	$15^{825}/_{945}$ shares	5.29%

Since all shares of stock referred to herein were of a par value of $100 each, the ratios of ownership remained the same or substantially the same in the new corporation as had existed in the old. The stock of the old corporation was turned in and cancelled and the new stock was issued to the stockholders of the old corporation in the same ratio as indicated above with no money being paid for the stock.

The new company received and owned the same assets as the old corporation had held prior to receivership, and no part thereof had been liquidated by the receiver. The changes in the financial condition of the new company, as compared with the old, were the assumption by the new company of a note payable in the sum of $25,000 (which sum was furnished by Mrs. Rika R. Meyer to Oppenstein to purchase assets from the receiver and which was subsequently repaid), and the relief of approximately $88,000 of other current notes and accounts payable which had been settled by the receiver from the proceeds of the $25,000 note referred to above on the basis of 25 cents on the dollar to creditors.

The net effect of the liquidation of accounts and notes of the old corporation at 25 per cent of their book liability was to increase the book equity of the stockholders by approximately $66,000, less the amount of receivership fees and expenses which totalled $6,515.

In setting up the financial statement of the new corporation, inventories were written down $47,696.10, which was about 50%; other assets, consisting of hubs, dies, patterns, machinery and shop equipment and furniture and fixtures, were written down by the net sum of $15,055.21, making a total writedown of $62,751.31. The reason for this writedown was to bring the assets more in line with a fairer value for a going concern. After this was done, the equity of the stockholders had a book value of $51,161.68. The balance sheet of the new corporation as of July 20, 1931, was as follows:

The Meyer Jewelry Company Balance Sheet July 20, 1931

ASSETS

Commerce Trust Co.—Cash		$ 4,934.40
Petty cash		200.00
Notes Receivable	$ 1,537.18	
Accounts Receivable—Trade	26,877.86	
Accounts Receivable—Misc.	400.00	
F. E. Hoevel, Salesman—A/c Recv.	100.00	
Insurance Claims Receivable	2,300.00	
	$31,215.04	
Less Res. for Bad Debts	6,400.00	
		$24,815.04
Inventory:		
Mat'l Watches & C. J.	$22,210.84	
Diamonds	9,715.30	
Mtgs. & Jlry.	14,091.31	
Gold, Silver & Platinum	3,981.15	
Stationary and Printing	500.00	
		$50,498.60
Hubs, Dies & Patterns		1,000.00
Machinery and Shop Equipment		4,000.00
Furn. & Fixtures		1,000.00
Automobiles	$ 707.75	
Less Res. for Depr.—Autos	307.75	
		$ 400.00
Prepaid Insurance		767.97
Total Assets		$87,616.01

LIABILITIES & NET WORTH

LIABILITIES

Notes Payable—Borrowed	$28,976.56	
Accounts Payable—Misc.	2,364.29	
Reserve for Taxes	199.33	
Reserve for Moving Expense	2,000.00	
Reserve for Legal Expense	2,914.15	
Total Liabilities		$36,454.33

NET WORTH

Capital Stock—Common	$30,000.00	
Surplus	21,161.68	
Total Net Worth		$51,161.68
Total Liabilities & Net Worth		$87,616.01

19. In her income tax return for 1931, Mrs. Rika R. Meyer claimed a loss of $89,400 representing the par value of 894 shares of stock held by her in the old company.

Her net income for that year was approximately $3,500, and she had a personal exemption of $1,500. There is no evidence in the record as to whether or not the Commissioner of Internal Revenue allowed such claimed loss.

20. Leon R. Meyer made cash contributions to the surplus account of the new corporation of $1,500 on March 31, 1937, and $10,000 on January 30, 1940, aggregating $11,500, which amount was a part of the value of the stock of the new Meyer Jewelry Company in the liquidation in 1943, when that company's assets were distributed to Leon R. Meyer and his wife, Lucile.

21. On December 29, 1941, Mrs. Rika R. Meyer made a gift to her son, Leon R. Meyer, of all of her shares of capital stock in the new Meyer Jewelry Company, and she reported such gift for federal gift tax purposes in a return filed by her for the calendar year 1941. Through inadvertence, her shares were reported as 284, instead of $284^{120}/_{945}$, the difference due to her interest in one share held by a member of the board of directors for qualifying purposes. Immediately after the gift, Leon R. Meyer beneficially owned all of the capital stock of the new Meyer Jewelry Company, being 300 shares.

22. On July 27, 1943, Leon R. Meyer made a gift of 150 shares of the capital stock of the new Meyer Jewelry Company to his wife, Lucile H. Meyer, and reported such gift for federal gift tax purposes in a return filed for the calendar year 1943.

23. After the foregoing gift was made by Leon R. Meyer to his wife, Lucile, each of them individually owned half of the stock of the new Meyer Jewelry Company.

24. At a special combined meeting of the stockholders and directors of the new Meyer Jewelry Company on July

27, 1943, a plan of liquidation of the Meyer Jewelry Company was adopted by which all of its assets were to be transferred to the individual stockholders as of the close of business July 31, 1943, in full payment of and in exchange for their capital stock in the corporation, said stockholders being Leon R. Meyer, owning 150 shares, and Lucile H. Meyer, owning 150 shares, the liabilities of such liquidating corporation to be assumed by the stockholders. Leon R. Meyer was appointed and acted as "Liquidating Agent."

25. Contemporaneously with the dissolution of the new Meyer Jewelry Company, Leon R. Meyer and his wife, Lucile, entered into an agreement reciting the formation of a copartnership under the firm name of Meyer Jewelry Company and their assignment to the copartnership of all of the assets transferred to them by the corporation. The corporation was liquidated and dissolved as of July 31, 1943, and thereafter for about two years the business of Meyer Jewelry Company was carried on as a copartnership.

26. The value of the assets of the new Meyer Jewelry Company received by Leon R. Meyer and his wife, Lucile H. Meyer, on July 31, 1943 in liquidation was $94,887.61, each receiving for his and her respective interest in the corporation, $47,443.81 and $47,443.80, which is based on their holding of an equal number of shares in the said new Meyer Jewelry Company, the $94,887.61, as so divided, to be used in the calculation of profit derived from such liquidation in exchange and payment for their stock in the corporation.

27. Plaintiff Leon R. Meyer, transferee in Case No. 49741, claims refund of excess profit assessments of $449.34 for the fiscal year ending January 31, 1943, and $3,395.63 for the period February 1 to July 31, 1943. These claims for refund are based upon plaintiff's adjustments of equity invested capital at the beginning of the aforesaid periods.

The new Meyer Jewelry Company's equity invested capital at the beginning of the periods involved herein was reported, and determined by the Commissioner of Internal Revenue, as follows:

	Beginning of periods	
	Feb. 1, 1942	*Feb. 1, 1943*
Reported by plaintiff on tax returns	$78,469.82	$87,326.92
Determined by the Commissioner:		
Paid in surplus	$11,500.00	$11,500.00
Property paid in for capital stock	30,000.00	30,000.00
Accumulated earnings and surplus	35,732.83	45,367.31
Total	$77,232.83	$86,867.31
Reduction in equity invested capital	$ 1,236.99	$ 459.61

The plaintiff now contends that its equity invested capital should be $130,100.55 at February 1, 1942, and $136,812.05 at February 1, 1943. In arriving at these amounts, plaintiff included capital surplus at July 18, 1931, in the receivership accounts of $62,810.31. The plaintiff contends the equity invested capital of the new Meyer Jewelry Company for the periods in dispute should be computed as follows:

Capital surplus account at July 18, 1931	$ 62,810.31
Accumulated earnings	25,790.24
Capital stock	30,000.00
Paid-in surplus	11,500.00
Equity invested capital for fiscal year ending January 31, 1942	$130,100.55
Accumulated earnings for 1943 period	6,711.50
Equity invested capital at July 31, 1943	$136,812.05

Assuming the Meyer Jewelry Company went through a "nontaxable reorganization" in 1931 within the meaning of those terms in section 112 of the Revenue Act of 1928, the evidence is insufficient to conclude that plaintiff's computation of equity invested capital is correct.

28. Upon the liquidation and dissolution of the new Meyer Jewelry Company on July 31, 1943, the Commissioner of Internal Revenue assessed against and collected income taxes from plaintiffs, Leon R. Meyer and Lucile H. Meyer, individually, on their gains resulting from the liquidation of the new Meyer Jewelry Company. The gains were computed on the following bases:

	Leon R. Meyer	*Lucile H. Meyer*
Liquidating dividends	$47,443.81	$47,443.80
Basis of stock (150 shares each)	1,533.33	9,966.67
Long term capital gain	$45,910.48	$37,477.13
Taxable 50%	22,955.24	18,738.57

The resulting income taxes and interest thereon were the amounts paid as shown in finding 29 herein.

The cost basis of $11,500 allowed by the Commissioner represents only that sum paid in as surplus by Leon R. Meyer (finding 20). It was allocated between the two owners of equal shares of the corporation as $^{2}/_{15}$ths to Leon R. Meyer and $^{13}/_{15}$ths to Lucile H. Meyer. This allocation was made upon the theory that when Leon R. Meyer paid in $11,500 to the surplus account of the corporation, such sum then became the cost of the 15 shares of stock he then held.

The last two certificates were issued July 16, 1943, No. 4 to Lucile H. Meyer for 150 shares, and No. 5 to Leon R. Meyer for 148 shares. Two older certificates, Nos. 2 and 3, had been issued February 1, 1943, to qualifying stockholders, but Leon R. Meyer remained as beneficial owner thereof.

The Commissioner adopted the theory that the oldest 15 shares outstanding at the time of liquidation carried the cost basis of $11,500; and since certificate No. 4, issued to Lucile H. Meyer, preceded certificate No. 5, issued to Leon R. Meyer, even though issued the same day, the oldest 15 shares, other than the two qualifying shares, were therefore issued to her.

29. Payments of income tax were made to the Collector of Internal Revenue, Sixth District of Missouri, Kansas City, Missouri, on October 13, 1947, by check of Leon R. Meyer, Meyer Jewelry Company, dated October 9, 1947, for the account of Leon R. Meyer for the calendar year 1943, $14,281.84, and for the account of Lucile H. Meyer for the calendar year 1943, $7,860.77. For the account of Leon R. Meyer, as transferee of the Meyer Jewelry Company, Dissolved, for its taxable year ended January 31, 1943, and its taxable period ended July 31, 1943, excess profits taxes of $3,844.97 were paid by Leon R. Meyer on the same date.

30. On October 11, 1948, plaintiffs filed claims for refund with the Collector of Internal Revenue for the Sixth District of Missouri for the following periods and amounts:

Name	*Period*	*Amount*
Leon R. Meyer	1/1/43 to 12/31/43	$14,281.84
Lucile H. Meyer	1/1/43 to 12/31/43	7,860.77
Leon R. Meyer, transferee	2/1/43 to 7/31/43	3,395.63
Leon R. Meyer, transferee	2/1/42 to 1/31/43	449.34

31. The foregoing claims were recommended for rejection by letters of the Internal Revenue Agent in Charge, St. Louis Division, dated April 1, 1949:

Name	*Taxable period*	*Amount*
Leon R. Meyer	1943	$14,281.84
Lucile H. Meyer	1943	7,860.77
Leon R. Meyer, transferee	(1/31/43)	449.34
Leon R. Meyer, transferee	(7/31/43)	3,395.63

The reasons given for rejection, with respect to the first two amounts are that the basis of the shares of Meyer Jewelry Company had been determined to be only $11,500. The letter with respect to the transferee liability stated that rejection was because the corporation did not undergo a non-taxable reorganization in 1931.

32. The said claims for refunds were finally rejected by Notices of Disallowance under Section 3772 (a) (2), In-

ternal Revenue Code, by letters of E. I. McLarney, Deputy Commissioner, dated October 26, 1949:

Name	*Taxable period*	*Amount*
Leon R. Meyer	1943	$14,281.84
Lucile H. Meyer	1943	7,860.77
Leon R. Meyer, transferee	1943	449.43
Leon R. Meyer, transferee	1943	3,395.63

33. If the Meyer Jewelry Company experienced a "nontaxable reorganization" in 1931 within the meaning of those terms in sections 112 and 113 of the Revenue Act of 1928, plaintiffs, Leon R. Meyer and Lucile H. Meyer, derived an aggregate capital gain of $7,817.46 in the liquidation of the new Meyer Jewelry Company in 1943, computed as follows:

Value of assets received by Leon R. and Lucile H. Meyer in liquidation of new corporation, 1943		$94,887.61
Cost of stock of new corporation surrendered by Leon R. and Lucile H. Meyer, in liquidation in 1943 (same as cost of stock of old corporation):		
Common stock of Lewis Meyer purchased by Rika R. Meyer	$30,570.15	
Cost of preferred stock to Rika R. Meyer	45,000.00	
Paid in surplus by Leon R. Meyer	11,500.00	
		$87,070.15
Capital gain to Leon R. and Lucile H. Meyer upon liquidation in 1943		$ 7,817.46

CONCLUSION OF LAW

Upon the foregoing findings of fact, which are made a part of the judgment herein, the court concludes as a matter of law the plaintiffs are not entitled to recover and their petitions are dismissed.

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In the Supreme Court of the United States

OCTOBER TERM, 1954

No. 493

LEON R. MEYER, PETITIONER

v.

UNITED STATES OF AMERICA

LUCILE H. MEYER, PETITIONER

v.

UNITED STATES OF AMERICA

LEON R. MEYER, TRANSFEREE OF MEYER JEWELRY COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1-13) is reported at 121 F. Supp. 898.

JURISDICTION

The judgment of the Court of Claims was entered on June 8, 1954. (Pet. App. 1, 13.) A timely motion for rehearing was denied October 5, 1954. The petition for a writ of certiorari was filed December 22, 1954. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1255.

QUESTION PRESENTED

Whether there was a tax-free reorganization within the meaning of Section 112(b)(3) and (i) of the Revenue Act of 1928 where the stockholders of an insolvent corporation purchased the corporation's assets at a receivership sale and formed a new corporation to which those assets were transferred.

STATUTE INVOLVED

Revenue Act of 1928, c. 852, 45 Stat. 791, 816:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges solely in kind.*—

* * * * *

(3) *Stock for stock on reorganization.*—No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock

or securities in such corporation or in another corporation a party to the reorganization.

* * * * *

(i) *Definition of reorganization.*—As used in this section and sections 113 and 115—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

STATEMENT

These consolidated cases were instituted in the Court of Claims as suits for recovery of individual income taxes paid for 1943 and of excess profits taxes paid by the Meyer Jewelry Company for its fiscal year ending January 31, 1943, and for the taxable period February to July 31, 1943. (Pet. App. 1-2.) On July 27, 1943, when taxpayers equally owned all of the stock of Meyer Jewelry Company, all of the assets of that corporation (valued at $94,887.61) were distributed to them, in pursuance of a plan of liquidation, in exchange for their stock. (Pet. App. 27-28.) In the income tax cases they claim that their gain on the liquidation was less than the amount determined by the Commissioner of Internal Revenue and base that claim on a contention that the old Meyer Jewelry Company experienced a nontaxable reorganization in 1931 which entitles taxpayers to add to their own bases for their stock in the new Meyer Jewelry Company the cost basis of the stock to the stockholders of the old corporation. (Pet. App. 5-6, 30-32.) The contention that the old Meyer Jewelry Company experienced a nontaxable reorganization in 1931 is also the basis of the claim of taxpayer Leon R. Meyer, as transferee of the new Company, to a refund of excess profits taxes paid by the latter. (Pet. App. 6-8, 29, 31.) The Court of Claims held that no nontaxable reorganization occurred in 1931 and accordingly dismissed taxpayers' petitions for refund of taxes. (Pet. App. 7-13.)

The court below made detailed findings of fact.

(Pet. App. 14-32.) Those facts which relate to the alleged reorganization of Meyer Jewelry Company in 1931 may be summarized as follows:

The Meyer Jewelry Company, herein sometimes called the "old corporation," was incorporated in 1890 under the laws of the State of Missouri. Its entire stock was originally owned by Lewis Meyer, taxpayer Leon R. Meyer's father. The corporation repeatedly experienced financial difficulties, and Mrs. Rika R. Meyer, taxpayer Leon R. Meyer's mother, from time to time furnished funds with which the corporation's obligations were met. As the result of various transactions over the years, in 1928 she became the owner of all the outstanding stock of the corporation, which then consisted of 500 shares of common and 450 shares of preferred stock, both of a par value of $100 a share. Some time prior to 1931, she gave 50 shares to taxpayer Leon R. Meyer. (Pet. App. 14-17.)

At the beginning of 1931 the corporation was again in such financial difficulty that it was faced with bankruptcy. As it had done on a previous occasion, it undertook to make a composition settlement with creditors. However, while negotiations were continuing, certain creditors with note claims in excess of $3,100 filed receivership proceedings against the corporation in the United States District Court for the Western District of Missouri. In these proceedings, the court appointed a receiver and turned over the old corporation's assets to him with directions to operate the business, sell the assets, and compromise and settle all claims

and demands against the corporation. The receiver operated the business for approximately four months during which time, on July 3, 1931, independent appraisers appointed by the court submitted their report to the court valuing the old corporation's assets at $50,211 (as against liabilities of approximately $88,000). Louis Oppenstein, acting as the agent of taxpayer Leon R. Meyer and Mrs. Rika R. Meyer (who had been the sole stockholders of the old corporation), offered to purchase the assets of the corporation for an amount sufficient to pay 25 percent of all lawful claims of the old corporation's creditors, plus court costs, receiver's fees, and certain additional amounts. On July 9, 1931, the court authorized the sale to Oppenstein, noting that the receiver had reported that he had been unable to realize from the old corporation's assets the $50,211 at which the disinterested appraisers had valued the old corporation's assets. The receiver thereupon sold all the assets of the old corporation to Oppenstein for $22,000, which was sufficient to pay off the creditors at 25 percent, plus receiver's charges and court costs which made the total cost to Oppenstein $28,515. The receiver reported the sale to the court on July 17, 1931, and, after approval of his accounts, he was discharged on August 28, 1931. (Pet. App. 17-20.)

On July 17, 1931, after the sale of the assets of the old corporation to Oppenstein, taxpayer Leon R. Meyer and Mrs. Rika R. Meyer, for whom Oppenstein had acted as agent, caused a new corporation to be organized under the name of Meyer Jewelry Company, with an authorized capital stock

of 300 shares of $100 par common stock. The certificate of incorporation was issued on July 20, 1931. On the same day there was held a combined meeting of the stockholders and directors of the new corporation at which a resolution was adopted covering a purported plan of reorganization which was neither contained in nor referred to by the record in the District Court in the receivership proceedings. Pursuant to this plan, the stock of the old corporation was turned in and cancelled and the stock of the new corporation was issued to the former stockholders of the old corporation (taxpayer Leon R. Meyer and Mrs. Rika R. Meyer) in the same ratio, with no money being paid for the stock of the new corporation, and the assets of the old corporation were turned over to the new corporation, which assumed and later paid a note in the amount of $25,000 covering the sum Mrs. Rika R. Meyer had furnished to Oppenstein to purchase the assets of the old corporation from the receiver. (Pet. App. 20-25.)

In setting up the financial statement of the new corporation, assets were written down $62,751.31 to bring them in line with a fairer value for a going concern. After this was done, the equity of the stockholders had a book value of $51,161.68 as compared with the liabilities of the old corporation in the amount of approximately $88,000. (Pet. App. 25-26.)

ARGUMENT

The crux of the decision below is the settled proposition that there can be no tax-free reorganization where there is no continuity of proprietary

interest between the owners of an old and a new corporation. *Le Tulle* v. *Scofield,* 308 U.S. 415, 420-421; *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 287 U.S. 462. On the unquestioned findings of the Court of Claims, this rule was properly applied to this case. The result, which is clearly correct and as to which there is no suggestion of conflicting decisions, presents no occasion for review by this Court.

As the court below found, contrary to taxpayers' assertion (Pet. 7-8), the old corporation was insolvent in a bankruptcy sense and the shares its stockholders held were worthless. The old corporation had current liabilities of approximately $88,000. (Pet. App. 19.) Although its merchandise inventory alone was carried on its books at $107,651.97, this book figure was no indication of the true value of the corporation's assets. Independent appraisers appointed by the court in the receivership proceeding appraised the assets at $50,211 (Pet. App. 18-19), and the new corporation itself, in setting up its financial statement covering the same assets, listed them at $51,161.68 (far less than the liabilities of the old corporation) to assign to them a fairer value for a going concern (Pet. App. 25). Contrary to taxpayers' statement (Pet. 8), the old corporation never became solvent. Its assets were sold by the receiver and the proceeds of the sale were used to pay off creditors at 25 percent of book liability.

In these circumstances, the court below properly applied the rationale of the full priority rule in

determining that there had been no tax-free reorganization. See *Helvering* v. *Limestone Co.*, 315 U.S. 179. The taxpayers are correct, of course, in stating (Pet. 6) that the rule is not a conclusive test of a nontaxable reorganization. But the court below did not apply it as such. The court simply gave effect to the rule in demonstrating what the facts of the receivership proceeding made clear beyond doubt—that the stock of the old corporation was worthless and that there was lacking, therefore, the continuity of proprietary interest requisite to a tax-free reorganization.

The decisive point is that, as stockholders of the old corporation, taxpayers Leon and Rika Meyer had lost their proprietary interest by virtue of the receivership proceeding pursuant to which the assets of the old corporation were sold for cash to pay off creditors. They had no equity interest in the old corporation to carry over to the new one in exchange for the latter's stock; as the court below pointed out (Pet. App. 11), they acquired this stock "by virtue of the purchase of the assets [of the old corporation] at the receivership sale." They were in a position like that in which third parties, strangers to the old corporation, would have been had they purchased the same assets and formed a new corporation for their employment. These obvious realities were not changed by the fact that the stockholders of the old corporation surrendered to the new corporation their worthless stock in the old corporation—a transaction which the court below properly held was a meaningless formality.

In comparable cases, the courts have held that no tax-free reorganization occurred. See *Mascot Stove Co.* v. *Commissioner,* 120 F. 2d 153 (C.A. 6th), certiorari denied, 315 U.S. 802; *D. W. Klein Co.* v. *Commissioner,* 123 F. 2d 871 (C.A. 7th), certiorari denied, 315 U.S. 819; *Templeton's Jewelers* v. *United States,* 126 F. 2d 251 (C.A. 6th); *Scofield* v. *San Antonio Transit Co.* (C.A. 5th), decided August 5, 1954 (1954 P-H, par. 72,723); cf. *Davis* v. *Bankhead Hotel,* 212 F. 2d 697 (C.A. 5th). Like those cases, the decision below is clearly correct.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

SIMON E. SOBELOFF,
Solicitor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
MELVA M. GRANEY,
Special Assistants to the Attorney General.

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